Business Planning and Financial Forecasting

A Start-up Guide

Western Economic Diversification Canada
Diversification de l'économie de l'Ouest Canada

BRITISH COLUMBIA
Ministry of Small Business and Economic Development

Small Business BC
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Western Economic Diversification Canada and the
Ministry of Small Business and Economic Development are pleased to publish
Business Planning and Financial Forecasting: A Guide for Business Start-Up.
This web-based guide is available on Small Business BC's website by clicking on
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For all your other business information needs go to British Columbia's award-
winning resource centre for business information and planning tools.

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The Business Plan

Introduction

You want to start a business – or expand your existing business. You have a great idea, super attitude and the entrepreneurial spirit. So you head down to your local bank or financial institution; you sit down in front of the credit manager and start to explain this brilliant idea when she interrupts you: *"That sounds great, but where is your business plan?"*

This scenario is played out every day in Canada – people with ideas who want to plunge into business without having done a business plan. The purpose of this guide is to explain in simple terms the business plan concept and to show you how to put your own plan together.

A Start-Up Guide leads entrepreneurs through the business planning process. By describing everything from Vision and Mission to Operational Strategies, the Guide provides an easy to read description of your new business concept. The affiliated "Financial Planning Template" helps entrepreneurs assemble their Starting Balance Sheet, Pro-Forma Income Statement and first year Cash Flow Forecast. This MS Excel template is available at http://www.cse.gov.bc.ca/ReportsPublications/FinancialTemplate.XLT. There is plenty of help available to you including courses from your local college or school board and of course the services and information resources of Small Business BC, including the *Interactive Business Planner* located at www.smallbusinessbc.ca/ibp.

Why do a Business Plan?

Your own thinking process is solidified through the planning process.

The planning outline provided in this guide leads you through a series of questions and issues that you should consider when thinking about your business. *Remember that you are an investor in your own business.* You are the first person who must have confidence in the validity of your business concept.

Your bank or financial institution will need to be convinced of the viability of your business, or your business expansion.

The business plan is a *communications tool* to inform and influence the reader towards some action – providing a loan, extending credit or investing in your business.

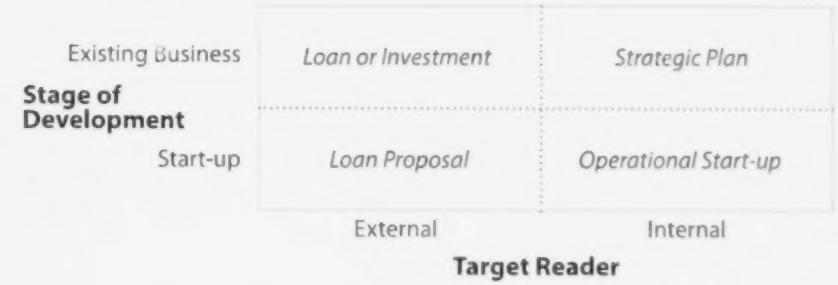
Your business plan provides some guideposts in running your business.

You will set goals and then, once you are in business, you can measure those goals against the actual performance. Goals should be specific, measurable, achievable, realistic and time limited – *SMART*.

What is in a business plan

There seem to be as many kinds of business plans as there are business planning guides. There are two ways to look at the business plan: by stage of development, and by target reader. Under the stage of development, there are generally two ways to divide the planning style: start-up plans and plans for ongoing businesses. Under the target reader there are also two ways to look at the plan: an inside reader and an outside reader.

Graphically, we can look at it this way:



There are of course many variations on the general categories. (For example, a rapidly growing business requires a slightly different emphasis for both its strategic and loan / investment plan.) Although there are different plans and different readers, there are similarities in each of the four plans – including the financial forecast, which is common to all business plans.

A business plan geared to an *external reader* is written with a specific objective in mind – usually a loan or an investment. Before writing the external plan, you as the business owner must believe in your business. After all, how can you convince a bank or financial institution to lend, or an investor to invest, unless you are personally convinced of the validity of the business?

A business plan geared to the *internal reader* serves two purposes. It is a road map for taking the business in a particular direction. It is also a litmus test for the business. Setting goals and objectives is one thing, but determining the steps needed to accomplish these goals is quite another. The planning process allows the entrepreneur to determine what might or might not work. For example, a business owner may research the idea of opening a chain of stores only to discover that franchising is a more effective way to expand the business. Likewise, in a start-up situation, an entrepreneur may discover during her market research that her hometown is not large enough to provide a sustainable market for her chosen endeavor. She can then consider a different type of business, or start her business in a different location.

This Guide

This guide to Business Planning and Financial Forecasting is written for the Start-up Business to communicate with an external reader, with special emphasis on banks or financial institutions.

Be clear and inform

You cannot assume that the reader of your plan knows anything beyond what you have stated in the plan. You may know what you mean, but have you clearly explained it to the reader? As you go through this outline, constantly ask yourself if you are making yourself clea. to a reader who is not familiar with your industry or your business. *Your business plan may be your only representation to an outside party such as a bank or financial institution!* In most business start-up situations, the lender is basing their decision on the viability of the business and the character of the entrepreneur. Your business plan not only represents your business – it represents you.

Here are a few tips on the actual writing of the plan:

Do's

- Try to keep it fewer than twenty pages, exclusive of the appendix.
- Use bullet points and numbered lists wherever possible.
- Use, but do not overuse, graphs, diagrams and photographs.
- Have a neutral third party read the plan – especially someone unfamiliar with your industry.
- Include a table of contents and page numbers in your plan.

Don'ts

- Avoid big words and long sentences. They only serve to confuse the reader.
- Don't use technical words and unnecessary jargon. If you need to introduce a technical term, then you should define it.
- Avoid using acronyms and initials to express words is another common error. You may be very familiar with the acronym but your reader might not. If an acronym has become as common as a word, such as SCUBA or LASER, then use them. If they are still technical, such as URL then you may need to define the acronym and its meaning.

Outlining your business plan

There are many different outlines you can use for your business plan. The following outline is designed specifically for the reader. A good plan for an outside reader anticipates and answers the readers concerns and important issues. To see a sample plan, go to: www.smallbusinessbc.ca.

Planning Outline

Introduction
- Business Concept
- Plan Goals and Objectives
- Management / Ownership

Products & Services
- Product / Service Mix
- Product / Service Risks

Market Research
- Industry Research
- Customer Research

Marketing Strategies
- Pricing
- Physical Distribution
- Promotion

Operations
- Process
- Procurement
- Personnel (Human Resources)
- Legal and Administrative

Finance
- Breakeven
- Starting Balance Sheet
- Pro-forma Income Statement
- Cash Flow Forecast
- Program and Finance

Elements of a Business Plan

Purpose: *The purpose of the executive summary is to get the readers attention by summarizing the key elements of the business plan. It must be short, to the point and very well written.*

This is arguably the most important part of the business plan. The *Introduction* must make your reader want to keep reading. It is a good idea to write as much of the *Introduction* as you can at the outset of the planning process. This initial writing will help you to focus your attention on the goals of the plan. You should then *rewrite* the *Introduction* after you have completed the rest of the business plan. This way the specifics of the plan, and the changes made during the planning process are accounted for. You are addressing the issues of what you do, where you are going in the short term and what you want from the reader of the plan. *This section of the plan should be two to three pages long.*

Business Concept

- Describe what your business does in general terms.
- Include your mission or vision statement.
- Describe what differentiates your business from others. This is important to the reader, as they want to know how your business will be able to create new customers. What do you offer that will take customers away from competitors?
- Briefly describe your business history if applicable.
- Provide any other information that will excite the reader about your business.

Goals & Objectives

- Tell the reader what you want (e.g. a business loan for a specific amount to purchase equipment).
- State your sales, production and profit goals. Be specific in amount and time line.
- If this is for a bank loan, comment on goals such as anticipated time to achieve a positive cash flow and the ability to service debt. (Note you cannot complete this section until the rest of the plan is complete.)

Management Ownership

- Briefly describe the technical qualifications of each principal in this enterprise.
- Briefly describe the business qualifications of each principal in this enterprise.
- Tell the reader your business structure (i.e. proprietorship, partnership, and incorporation).
- Provide a fact sheet with contact information such as name, address, telephone, e-mail, etc.

Products and Services

Purpose: *The purpose of the product/service section is to detail exactly what your business does for the customer and what makes these offerings desirable.*

Product Oriented Businesses

- Describe each product you sell. The combination of products is your product mix.
- If you cannot list each product, break the business down into logical categories.
- Describe the key product features, and how your products are different from those of your competition. (Functionality, durability, ease of use, etc).
- Describe product protection such as patents, copyrights and trademarks.

Service Businesses

- Describe each type of service you offer (be specific).
- Describe the service features in terms important to the customer.
- Describe any service protection such as copyrights or trademarks.

Product Risks

If there are any risks associated with your product or service such as product liability, professional liability, or ease of duplication by competition, state them and describe how you will mitigate these risks.

Market Research

Purpose: *The purpose of the Industry and Market Research section is to prove that the market is large enough in your area to support the survival and growth of your business.*

Industry Research

Describe your industry. If you are in a new industry, or an industry not well known to a reader, this will be a fairly comprehensive section. A better known industry requires less explanation.

- Describe the state of the industry. Is it a new industry, growth industry, competitive industry, or a stable mature industry?
- Document industry trends on a local, national or world scale. Sales, number of customers, number of units sold, trends in related industries are all good industry indicators.
- Describe the key customers for your specific industry.
- Provide other national/international economic indicators that encourage the health of your industry.
- Examine risks to the industry caused by legislation, technological change or any threat to the industry as a whole.

Target Market - Customer Research

The Target Market is the groupings of consumers or businesses most likely to purchase your products or services. The first group you plan to target is your *Primary Target Market*; the second is your *Secondary Target Market*. It is very important that you understand your target markets – after all, these are the customers you need to keep happy!

	Consumer Markets	Business Markets
Who is the customer? (Provide both the description and the information in this section.)	• Age • Gender • Income • Family Status Be sure to include how many customers there are in each grouping.	• Industry Type • Size of Customer • Annual Sales Estimate the number of companies using directories or Yellow Pages.
Where is the customer?	Target the geographic radius of your customer base by city, region province or country.	The geography of business to business markets tends to be larger than consumer markets.
When do they buy?	Is there a particularly busy season for your product or service?	If you are selling to seasonal businesses, the timing can be everything. (e.g. wholesaling)
What do they buy?	• Necessity • Luxury Item • High involvement/Big ticket • Low involvement/consumable	• Inventory Item (e.g. item that is resold) • Capital Item • Consumable Item
Why do they buy?	How does your product or service help the consumer?	How does your product enhance the performance of the customers' business?
How much do they buy?	Determine how much is spent on your product by your customers.	Estimate the commercial expenditure by the industries in your target area.

Note: *If you are using indirect distribution, it may be necessary to describe both your customers as a target market, and the end user as a target market.*

It is a good idea to state your sources. This gives the reader more confidence in the information and in the case you are making for your business.

Competitive Analysis

- Provide the results of any customer survey work you have done and the sources of information.
- List the direct competitors in your local market. These are firms who offer exactly what you offer. List the current number and the number in existence for the past three-year period.
- List the indirect competitors in your local market. These are firms who offer substitute products.
- Analyze any competitors who have gone out of business in the past and if possible describe why their business failed.
- Explain how your firm will compete with these competitors to prove how you can survive in their markets.
- Examine risks that could occur when you enter the market. For example, what if your key competitor cuts their price when you open your business?
- Position your product. Show how your products/services or company is different from your competition.

Market Strategies

Purpose: *The purpose of the Marketing section is to demonstrate how you plan to tap your market. This includes pricing, distribution, sales and promotional strategies.*

Marketing is one of the most misunderstood aspects of business. To many, marketing is sales and promotion. Sales and promotion are important elements of marketing, but marketing is a broader concept. It envelops the design and packaging of a product – the price and discounting strategies for the business – and the intimate knowledge of the current and future needs and wants of the target market. To create a balanced approach you should research all elements of marketing– not just advertising, sales and promotion. Here are some of the key elements of marketing you want to address in your business plan.

Price Strategy

- What are your prices for different products and services?
- How did you arrive at those prices? (i.e., Charge going rate, industry standard mark-up, etc.)
- Do you have any price packages?
- What is your price image? (i.e., bargain, middle of the road, high end) Is this consistent with your target market?
- How do your prices compare with your competition?
- Have you accounted for markdowns and off price promotions?

Physical Distribution

Describe which of the following distribution systems you plan to use in your business:

- Direct Distribution – selling directly from producer/provider to the customer.
- Wholesale Distribution – selling to a retailer who sells to the customer.
- Brokers or Agents – using a third party to sell the product – usually on a commission basis. This can be done for goods (Manufacturers' Agents) or for services (Speaker's Bureau).
- Hybrid Distribution – Using more than one of the above.
- Internet Sales – See Internet Strategies Section.

Location

- Neighbourhood Location (use a map). Traffic counts and supporting information such as population radius is helpful. *Remember to include direct and indirect competitors on your map.*
- Site Location – place in a mall, shopping centre, or city block. Show the other tenants and access/egress for parking if applicable.
- Facility Location – including a diagram of the business layout.
- Signage – both inside and outside the business.
- Location risks. For example, a median placed in the middle of your road will cut off access to your business. Check with your city-planning department before signing a lease.

Advertising & Promotion

Your promotional strategy is made up of three main areas. Not all businesses use all three, so only include the parts relevant to your situation. Small Business BC has resource people dedicated to help clients with this aspect of your business.

Advertising Plan (Paid Advertising)

- Provide a list of the media you plan to use. You may include newspapers, magazines, radio, television, direct mail or Internet advertising.
- Develop a monthly advertising schedule with planned budget amounts.
- If you have written any ads or brochures, include them as appendices to the business plan.

Public Relations Plan

- Include media sources you plan to use to promote your business.
- Include press releases in the appendices to the business plan.
- If you are using a Public Relations firm indicate the name of the firm in this section.

Personal Selling Plan

- Describe how you will prospect and find new customers.

- Describe how you will provide new customers with information.
- If you have letters of agreement, contracts or other sales tools, it is sometimes advisable to include them as appendices to the business plan.

Internet

Canada uses a consumer benefit model known as ICET. You should describe your Internet strategy in the same way with the following:

- Information Gathering – This includes the information provided to the consumer about your business, products and services.
- Communication – This includes more specific forms of two-way communication such as customer service and feedback mechanisms.
- Entertainment – This is the multimedia aspect approach to your site. This includes animation, sound clips and video clips.
- Transactions – This is the ability to actually order and pay for products over the Internet.

Operations

Purpose: *The purpose of the Operations section is to indicate how you plan to operate the business. This means how you will produce the services or provide the products.*

Production Plan (Manufacturing Businesses)

The production plan demonstrates your ability to produce products. This section may not apply to service businesses.

Production Flow Chart (Manufacturing businesses)

- Provide a flow chart/process diagram showing the entire production process from start to finish.
- List and budget production equipment required for the business.

Procurement (Businesses that manufacture or sell products)

- Sources of supply and order lead time.
- Terms and conditions of sale.
- Alternate sources of supply (this addresses procurement risk).
- Inventory control systems.
- Physical space requirements (unless covered in location sections).

Sub Contractors (both goods and services)

- Provide a list of sub-contractors.
- Show exactly what these sub-contractors do and where they fit into the production of the business.
- Show alternative sub-contractors (this addresses sub-contract risk).

Human Resources

Purpose: *The Human Resources section demonstrates how you will determine your HR needs, fill them, manage your staff and pay them.*

Staffing

- Organizational chart (show reporting structure).
- Job descriptions (show what people do).
- Job specifications (show the skills and knowledge required to do each job).
- Recruiting – Where will you find good people?
- Management – How will you treat those good people?
- Compensation – How much will you pay your people? This includes base wages, commissions, bonuses and other incentives. (Don't forget your statutory benefits of EI, CPP, WCB & Holiday pay, in addition to any benefits you plan to add.)
- Human resources risks. Look at contingent plans for loss of key personnel, labour shortages or strikes.

Professionals & Mentors

- Accountant
- Lawyer
- Bank Services
- Business Advisors and Mentors (it can be helpful to provide single-paragraph biographies on key business advisors.)

Legal & Administrative

- Legal Form (proprietorship, partnership, corporation, cooperative).
- Share Distribution (Corporation Only)
- Directors & Officers (Corporation Only)
- Buy Sell Agreement (Corporation and Partnerships Only)
- List of key legal agreements such as contracts, leases, agreements, franchise agreements, personal loan guarantees etc. The actual documentation is often put into the appendix of the business plan.
- Insurance/Risk management

Financial Plan

Purpose: *To show the financial requirements to start the business, and to keep the business profitable and liquid.*

- Starting Balance Sheet
- Pro-Forma (Forecast) Income Statement
- Cash Flow Forecast
- Notes to the Financial Plan
- Statement of Personal Net Worth (for lending purposes)

Appendices

Purpose: *The purpose of the appendices is to provide supporting documents for claims made in the business plan. They may not necessarily be read, but are there for reference purposes.*

- Resumé(s) of principals
- Letters of agreement / intent (potential orders, customer commitments, letters of support). This adds a great deal of credibility to the outside reader, including the bank or financial institution.
- Sample ads and brochures
- Collation of market surveys
- Other
- Price lists
- Personal net worth statement (including personal property values, investments, cash, bank loans, charge accounts, mortgages, other liabilities. This will substantiate the value of your personal guarantee if required for security.
- List of inventory (including type, age, value)
- List of leasehold improvements (including description, when made)
- List of fixed assets (including description, age, current market value of any equipment; legal description of any lands; description of any encumbrances on assets to be pledged for business purposes)
- Description of insurance coverage (e.g. insurance policies, amount of coverage)
- Aged accounts receivable summary
- Aged accounts payable summary
- Copies of legal agreements (e.g. contracts, lease, franchise agreement, mortgage, debentures)
- Appraisals (include recent appraisals of assets such as buildings, property, and equipment or provide a market evaluation of the business and an asset list outlining the asset, the year purchased and amount paid)
- Financial statements for associated companies (where appropriate)
- Name of present lending institution (including branch, type of accounts)
- Lawyer's name (include address and phone/fax number)
- Accountant's name (include address and phone/fax number)

Some final thoughts on planning

A famous general once said: *"In preparing for battle, I have found that plans are useless, but planning is indispensable."* Starting a business is a great undertaking. You want to be prepared. So here are some tips to keep in mind while in the planning process:

- Keep an open mind. Don't try to make something work that cannot work, just because you like the idea.

- Remember the Rule of 2 and 3. It takes twice as much money and three times as long as we anticipate. So plan accordingly.
- Be flexible – while developing the business plan other ideas, markets, products or services may come to mind. Explore them.
- Make your mistakes on paper – it is far cheaper than making them in real life.
- Keep planning! It can be difficult to plan when you are running your business, but it is very useful to re-examine your goals and objectives on a regular basis. Don't ever let the business squeegee out the creative entrepreneur.

Use all available resources to help you develop your plan.

This can include formal and informal mentors, other entrepreneurs or friends who will act as the "devil's advocate." Small Business BC provides a business plan review service, and an *Interactive Business Planner* at www.smallbusinessbc.ca/ibp. Community Futures Development Corporations (CFDCs), throughout rural British Columbia, are another excellent source of business advice. To locate your nearest CFDC go to www.communityfutures.ca/provincial/bc and click on *Locations*.

Are you ready for the lifestyle?

Self-employment is not for everybody! Try one of the many self-assessment guides. Western Economic Diversification Canada offers such a test at http://www.wd.gc.ca/tools/xindex_e.asp. It will at least make you more aware of the entrepreneurial lifestyle and the challenges.

Most of all – be persistent.

Sometimes you will try many variations on a theme. You may have to increase or decrease a product mix – change the way you distribute your product or even change the business.

2 The Financial Plan

Introduction

The financial plan is critical to the success of your business plan – especially if it is for the purpose of getting a bank loan. The Cash Flow Forecast is arguably the most important part of the plan, but each of the other documents is important from a planning perspective. There are three sections in a financial plan:

- The Starting Balance Sheet
- The Pro-Forma (or Forecast) Income Statement
- The Cash Flow Forecast (each of these sections should have notes of explanation for the reader).

The Financial Planning Template

To assist you in this process, we have created a template written for MS/Excel. Click here to access the template. This will take you through seven worksheets, each asking for financial information. This information is then assembled into the three statements described above. Information can be changed, and the results of the change are immediately calculated. This will take you to a reasonable first draft of your financials – but you will have to make some final adjustments for your particular situation.

If you are using a printout of this guide you can find the Excel template under http://www.cse.gov.bc.ca/ReportsPublications/FinancialTemplate.XLT.

Before You Get Started

The Beauty of "What If?"

It is almost impossible to get things right the first time. In all business planning, but especially in the financial section, it is important to try different scenarios. What if I purchase used equipment instead of new equipment? What if I raise or lower prices? What if I reduce my personal draw? By trying different scenarios, you will soon determine what it will take to make your business financially viable.

With business planning, you must keep trying until you have a result that is reasonable and that you are convinced is achievable.

Five Tips on your Financial Plan

1. **Be persistent!** Most people do not have expertise in finance so preparing a financial plan is a journey into the unknown. Be patient.
2. **Read the entire planning guide** before starting on the plan. You will learn what information you require to assemble the financial part of the plan.
3. **Get help in assembly, but not in research.** These should be your numbers and assumptions. You will be responsible for achieving these objectives so you should believe in the numbers.

Financial Plan Outline

Starting Costs

- Estimate Current Assets
- Estimate Capital Assets
- Estimate Start-up Expenses

Starting Balance Sheet

- Total Assets (from above)
- Planned Investment (Equity)
- Planned Loans (Liabilities)
- Balance Sheet Formula
- Assets = Liabilities + Equity

Income Statement

- Start-up Expenses (from above)
- Forecast Revenue
- Forecast Cost of Goods
- Forecast Overhead Expenses
- Revenue - Expenses = Net Profit

Cash Flow

- Estimate Monthly Sales
- Adjust Monthly Sales for AR
- Account for loans & investments
- Calculate Total Receipts
- Estimate Monthly Purchase
- Adjust for AP
- Estimate Monthly Overheads
- Estimate Loan Repayment
- Forward Start-up Costs
- Calculate Disbursements
- Starting Balance
  + Receipts
  - Disbursement
  = Ending Balance

4. **Be consistent.** Make sure that your financial plan is consistent with the rest of the business plan. For example, if your pricing section mentions a margin of 40%, this should be reflected in your Income Statement.
5. **Use the simple template provided.** (It is an *Excel* download.) Although it will not provide a final plan, it will get you well on your way in the journey. Go to http://www.cse.gov.bc.ca/ReportsPublications/FinancialTemplate.XLT.

Calculating The Break-even

The break-even point in your business is the point at which your sales revenue equals your total expenses. At that point you neither make money, nor do you lose any. The break-even lets you know what it is going to take in sales just to survive. It provides a good indication of the viability of a business project.

The break-even can also be used to evaluate a business expansion or any other business expenditure. You are simply asking how much additional revenue will be required to cover the additional cost. There are some key definitions necessary to determine the break-even for the business. They are:

Fixed Costs (Overhead) are costs that do not vary directly with sales. Utilities, salaries, advertising, office supplies and telephone are just a few examples. They do not have to be the same every month. What is important is that you pay them regardless of sales made.

Variable Costs (Cost of Goods) are the actual costs of making the product or providing the service. They can include materials, shipping and contract labour.

Capacity governs your output. It can be measured in units of production, billable hours, or sales volume. To calculate the break-even in units we use the following formula:

$$\frac{\textbf{Fixed Costs}}{\textbf{(Unit Price - Unit Cost)}} = \textbf{Break-even in Units}$$

This method is known as *Total Absorption Costing*, because dividing the total cost by the units sold absorbs the fixed costs. Every business plan – be it for growth or for start-up – needs to establish project and business costs *before* proceeding.

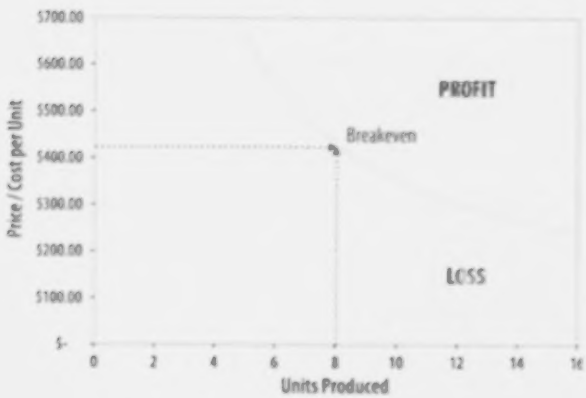
Note: *For planning purposes treat the entire term loan payment, both principal and interest, as a fixed cost to the business.*

Example

Jan is a home-based potter who makes custom mugs by the case. Her capacity is no more than 15 cases of mugs per week. She has calculated the variable cost for each case, including clay, glaze and packaging to be $50 per case. It costs Jan $3,000 per week to run her business, including her wage. The cost per case, when we include the $3,000 per week in fixed costs, changes depending on the number of cases produced each week. This is calculated in the table following.

Units Produced	Fixed Costs	Variable Costs	Price Per Unit
5	$ 3,000	$ 250	$ 650
6	$ 3,000	$ 300	$ 550
7	$ 3,000	$ 350	$ 479
8	**$ 3,000**	**$ 400**	**$ 425**
9	$ 3,000	$ 450	$ 383
10	$ 3,000	$ 500	$ 350
11	$ 3,000	$ 550	$ 323
12	$ 3,000	$ 600	$ 300
13	$ 3,000	$ 650	$ 281
14	$ 3,000	$ 700	$ 264
15	$ 3,000	$ 750	$ 250

Notice that the break-even is not a point, but it varies for each different price point. If she can get $425 per case for her mugs, she needs to be able to produce and sell eight cases of mugs per week. We can plot this on a graph as follows:



The area above the line is profit and the area below the line represents loss.

Break Even with a Gross Profit Margin

Sometimes, a company does not sell products, or it sells so many different products that doing a break-even for each unit does not make sense. When this is the case, such as in a retail business, we calculate the break-even in revenue rather than in units.

This is done with the following formula:

$$\frac{\text{Fixed Costs}}{\text{Gross Margin}} = \text{Break-even in Units}$$

Where:

$$\frac{\text{(Price - Cost)}}{\text{Price}} = \text{Gross Margin}$$

There are industry standard financial ratios available from Industry Canada for many small businesses. They are found at the Strategis website www.strategis.ic.gc.ca.

Fixed Costs

Example

Sarah wants to start a retail gift store. She estimates her monthly fixed costs at $9,000 per month. She determines that the industry standard Gross Margin for a gift store is 45%. She calculates her break-even as follows:

$$\frac{\$9{,}000}{45\%} = \$20{,}000 \text{ per month}$$

Sarah must be convinced that this location is able to sell at least $20,000 per month (or $240,000 per year) before she starts her business. Her market research, physical location, promotional plans and physical size must all support at least this level of sales capacity or the business will not work.

The break-even is a great first step in *evaluating* business opportunities. The business should make a profit, but the break-even is often the first step in determining the viability of a business idea.

The Balance Sheet

The Balance Sheet is a snap shot of the business at any point in time. In the case of a business start-up, it is often the starting balance sheet. A balance sheet is made up of three parts.

Assets: Things a business owns
Liabilities: Debts a business owes
Equity: The owners' investment and re-investment in the business

Everything that the business owns (its assets) must bepaid for; free of debt owing. Therefore we get the following formula:

Assets = Liabilities + Equity

This is extremely important as it gives the reader a picture of how the business is being financed through the owners' money (equity) or through the creditors' money (liabilities). In a business start-up you should look at the assets required to get the business started – and then ask yourself how you will finance that start-up. If you do not have the money to invest into the business, you will have to borrow the remainder.

Sample Balance Sheet

XYX COMPANY LTD.
Year Ending July 31, 2005

Assets		**Liabilities**	
Current Assets		*Current Liabilities*	
Cash	$5,000	Line of Credit	$2,000
Accounts Receivable	$10,000	Accounts Payable	$1,500
Inventory	$4,000	Wages Payable	$1,000
Pre-Paid Insurance	$1,200	Current Portion of Term Debt	$2,000
Total Current Assets	**$20,200**	**Total Current Liabilities**	**$6,500**
Capital Assets		*Non-Current liabilities*	
Macheriny & Equipment	$18,000	Term Loan	$20,000
Automobiles	$20,000	Less Current Portion	-$2,000
Leasehold Improvements	$24,000	Shareholders Loan	$30,000
Total Capital Assets	**$62,000**	**Total Non Current Liabilities**	**$48,000**
		Equity	
		Initial Investment	*$20,000*
		Retained Earnings	*$7,700*
		Total Equity	**$27,700**

How to Do a Balance Sheet for A Business Start-up

This section relates to the Start-up Costs section of the template.

The start-up balance sheet is simple if you know how to make and sort a list. You need to make two lists to get started. The first list is your list of *Current Assets.* These are assets (things your business owns) which will be used up within the first year of doing business. Typically they include cash, inventory and pre-paid expenses (such as pre-paid insurance). Although Accounts Receivable is another example of a current asset, there are no accounts receivables in a business start-up.

The second list is the *Capital Assets.* These are items you purchase with the intention of keeping them and using them to run the business. For example, if you purchase a vehicle to use in the business, it is a capital asset. If you purchase a vehicle to re-sell it, however, then that vehicle is inventory.

Sometimes there is a third asset list. These are known as Intangible Assets and are things such as franchise fees, goodwill, quotas, licenses, patents and trademarks. These are not common in most business situations except where you are purchasing an existing business.

Forecasting Your Assets

A: Determine and Budget your Current Assets

Starting Cash (You must have enough to cover your start-up expenses)	$ _____
Starting Inventory	$ _____
Pre-Paid Expenses (Usually Insurance)	$ _____
Other Current Assets	$ _____
Total Current Assets (A)	**$ _____**

B: Determine your Capital Asset needs.

Machinery and Equipment	$ _____
Office Furnishings, Fixturing & Other	$ _____
Automobiles	$ _____
Computers and Data Processing Equipment	$ _____
Leasehold Improvements	$ _____
Tools and other assets valued at Less than $200	$ _____
Computer Software (Excluding Systems software)	$ _____
Other Capital or Intangible Assets	$ _____
Total Capital Assets (B)	**$ _____**
Your Total Assets are A + B	**$ _____**

Your second step is to determine how you are going to *finance* this total. What combination of Debt and Equity will allow you to get your business started?

Forecasting your Liabilities and Equity

This section relates to the Financing and Balance Sheet section of the template.

Now that you have an estimate of how much you need to get started, you must determine how best to finance your business start-up. There are only two places this money comes from when you are starting up – loans or investment. Venture Capital for start-up businesses is exceedingly rare. Most businesses are financed through three sources: the owners, their suppliers and the bank!

There are typically three sources of debt financing in a business start-up. They are:

Supplier Credit: Sometimes a supplier will provide credit to their customers. Usually this is for inventory, however some suppliers will provide longer term financing for equipment or automobiles. Either way it is considered as a loan to the company. Supplier credit is not always afforded to a new business, so you may need to finance your starting inventory with bank debt or equity.

Bank Term Loan: A bank term loan is usually used for financing the capital assets of the business. It can sometimes be used to finance part of a business start-up or business acquisition. The loan is repaid over a period of time, and the interest rate may be fixed or floating.

Bank Line of Credit: This is similar to an overdraft for a business. It is important to use the line of credit to finance *current* assets and the term loan to finance *capital* assets. One sure way to have a cash flow crunch is to have used all your cash and line of credit to purchase a piece of equipment, only to run out of cash due to a late paying customer. It is not usual to finance a business start-up with a line of credit. It is, however, acceptable to finance short-term cash deficits using your line of credit.

Shareholders Loans: This can only happen in a limited company. You, as a shareholder, lend money to the corporation. This is an alternative method of investing in the company. Seek professional advice before deciding if using a shareholder loan is the best strategy for your business start-up.

Investment: This is the equity investment you put into your own company. The other type of equity is *Retained Earnings*, which are the profits, after income tax, kept in the business to ensure its growth. (Keep in mind there is no retained earnings in a start-up company).

Using the information dicussed above you can create the

Starting Balance Sheet

Assets

Current Assets

Cash

Inventory

Pre-paid Expenses

A Total Current Assets $ _____

Capital Assets

Machinery and Equipment

Office Furnishings, Fixturing and Other

Automobiles

Computers and Data Processing Equipment

Leasehold Improvements

Tools and other assets valued at less than $200

Computer Software (excluding systems software)

Other Capital or Intangible Assets

B Total Capital Assets $ _____

A+B Total Assets $ _____

Liabilities

Current Liabilities

Line of Credit

Supplier Credit

C Total Current Liabilities $ _____

Non Current Liabilities

Term Loans

Vendor Credit

Shareholder Loans

D Total Non Current Liabilities $ _____

C+D Total Liabilities $ _____

Equity

Investment

E Total Equity $ _____

C+D+E

Total Liabilities + Equity $ _____

Note that ***Total Assets*** **(A+B)** are equal to ***Total Liabilities + Equity*** **(C+D+E)**

The Income Statement Forecast

This section relates to the Pro Forma Income Sheet in the template.

The purpose of the Income Statement Forecast is to project the revenues and expenses of your business over a given period of time – usually one year. Other terms for this are budgeted income statement or pro forma income statement. There are three things that need to be predicted to forecast your income statement: the sales projection, the cost of goods projection and the overhead projection.

The Sales Forecast

The sales forecast is probably the most difficult part of the business to forecast, especially for a starting business. Sometimes, the break-even can provide a starting point for creating the sales forecast. A sales forecast is not like a weather forecast. A weather forecast is something you try to forecast, but something over which you have no control. A sales forecast is a goal you set for the business that you proactively try to achieve. In the case of an existing business, you should look at the sales history. You should see if your sales are trending up or down, and then account for new products to be added, or old products to be taken away. The sales forecast

must reflect your business strategies and objectives.

Forecasting using the Unit Method

List all the products or services you plan to sell. You will need to forecast the number of units of each type you plan to sell. Different businesses and industries use different unit measures (e.g., for a craftsperson, a unit may be one wooden item; for a researcher, a unit could be one hour of time). You will have to estimate the selling price for each unit. You can then develop a sales forecast using the following equation:

Price per unit × Number of Units sold = Revenue

Your marketing section must support sales volume and price and your operating section must support this level of production. Demonstrate that you can make this number of units, sell this number of units and justify the price you charge.

Forecasting with the Sales Method

Sometimes a business cannot use unit sales, as it would be impossible to predict the unit sales for each of 5,000 items in a gift store. In this case, some business owners will go directly to revenue forecast. If the business is broken down into logical departments or categories, then forecast the revenue in each area for the total sales forecast. Try to compare this to the market size and the number of competitors in the market.

The Cost of Goods Forecast

The cost of goods forecast relates directly to the sales forecast. The cost of producing goods varies directly with the level of sales. To calculate the cost of goods forecast, you may use either the unit costing method or the percentage cost method.

Unit Costing Method

This method is exactly like the unit sales forecast, except instead of using price, you use cost per unit.

Cost of goods = Number of units sold x Cost per unit

Just as in the unit forecast, you must do this for each unit sold. The sum of the cost of goods is then part of the income statement.

The Percentage Cost Method

In retail businesses, where mark-ups and markdowns predominate, it is common to use the cost complement to calculate the cost of goods. The cost complement is the percent of the revenue, or the selling price, which represents the cost of goods. For example, if an item costs $12.00 and is priced at $20.00 then the cost complement is $12.00 / $20.00 = 60%. (If the cost complement is 60% then the Gross Profit Margin is 40%). You can use the historical cost complement or industry standards to forecast the cost of goods and gross profit for your income statement.

The Overheads Forecast

The overheads forecast is an estimate of your expenses for the year. This list should be similar to the list developed for the fixed costs of your break-even analysis. Typical overhead expenses include:

- Advertising and Promotion
- Automobile
- Bank and Finance Charges
- Communications
- Depreciation
- Insurance
- Entertainment and Meals
- Occupancy
- Owners' Drawing or Wage
- Mail and Office Supplies
- Professional Fees
- Professional Development
- Wages and Benefits
- Travel and Accommodations
- Other

The next step is to make cost estimates for each area. You may do them monthly, or annually, however, you will eventually need to know your monthly expenditure in each area for your cash flow forecast. Some of your forecasts will be a matter of calling a supplier and asking for a quote – insurance is an example of this kind of overhead. Sometimes, you will have to make a management decision about how much you plan to spend in order to achieve your revenue objectives.

If you have a business history, you should use that history as a guide, making sure that increases and decreases in cost are consistent with your revenue objectives.

You should make a brief note to the reader of the plan, describing the key expense of forecasted items (i.e. you may have a quote from a broker for your insurance projection). This is especially true if, in an existing business, there is a large change in the statement.

Note: *The term draw in a Proprietorship refers to the money that the owner takes out of the company. The profits kept in the business are known as retained earnings. These earnings are reflected in the owners' equity portion of the balance sheet. It should also be noted that in a proprietorship, income tax is paid on the net profit – not the owner's draw.*

Sample Income Statement

XYX PROPRIETORSHIP

Income Statement

Year Ending December 31, 2001

Sales	**$130,000**
Less Cost of Goods	78,000
Gross Profit	52,000
Expenses	
Advertising	1,500
Depreciation	5,000
Interest	2,000
Rent	4,000
Travel	600
Wages	7,000
Total Expenses	**$20,100**
Net Profit	$31,900
Less Owner's Draw	30,000
Net Profit after Draw	**$ 1,900**

The Cash Flow Forecast

This involves three parts of the template. The Cash Flow Information sheet, the Seasonality sheet and the resulting Cash Flow.

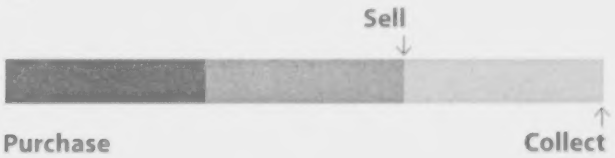
A Cash Flow Forecast is probably your most important financial tool. It is your cash flow that shows you if, and when, you will run out of cash essential to run your business. It allows you to take action before problems occur and even do "what if"

calculations before taking on new projects. The cash flow is a 12-month projection that forecasts the receipts and disbursements for your business. In a start-up situation, it is preferable to have a start-up month to specifically show the reader the costs incurred to start the business.

Cash flow is arguably the most important aspect of business. This is due to what is called the *Current Asset Conversion Cycle*. This is the time, in days, it takes to purchase a product or materials, produce and sell an item, and then finally collect on that item.

Current Asset Conversion example

For example, suppose a business purchases $1,000 worth of raw materials at the beginning of the month. They take one month to produce the product, one month to sell the product for $2,000 and one-month to collect their cash from their customer. If they do not receive any vendor credit for their raw materials, the process looks like this.



We have to put out $1,000 at the beginning, but do not collect $2,000 for three months. We still need to pay the overhead expenses in the interim. Without cash, or access to credit, we can go bankrupt before collection. Then we need to worry about selling the product in a timely manner and collecting in a timely manner. Failing to understand this part of business is one of the reasons that many experts in entrepreneurship and small business consider poor cash planning the single biggest cause of business failure.

Why do a Cash Flow Forecast?

Too often business owners do a cash flow forecast in their head. Putting the cash flow forecast on paper, however, will give you the following:

- A format for planning the most effective use of your cash (cash management).
- A schedule of anticipated cash receipts – follow through to see that you achieve it!
- A schedule of priorities for the payment of accounts – stick to it!
- A measure of the significance of unexpected changes in circumstances; e.g., reduction of sales, strikes, tight money situations, etc.
- A list, on paper, of all the bill paying details which have been running around in your head, keeping you awake nights.
- An estimate of the amount of money you need to borrow in order to finance your day-to-day operations. This is perhaps the most important aspect of a completed cash flow forecast.
- An outline to show you and the lender that you have enough cash to make your loan payments on time.

Receipts

Receipts occur when cash enters the business for any reason. It is like making a deposit in your current account. The main reasons for receipts are:

- Cash sales.
- Collection of accounts receivable.
- Loan proceeds. This includes term loans, start-up loans, line of credit and notes.
- Owners' contributions. This includes both investments and shareholders' loans (shareholders' loans only happen in incorporated companies).

Disbursements

Disbursements occur when cash leaves the business for any reason. The main reasons for disbursements are:

- Cash expenses or inventory purchases.
- Payments of accounts or expenses payable.
- Loan repayment (either bank or shareholders' loans).
- Owner repayment (dividends in a corporation or drawings in a proprietorship).

In cash flow, we talk about receipts, disbursements and deficits or surpluses rather than revenue, expenses and profits or losses.

How to do your Cash Flow

The cash flow is made up of three distinctive parts: the receipts, the disbursements and the cash flow calculation. Because of the complexity of the disbursement section, this section has been broken down into a series of smaller sections. These sections are:

1) Receipts

a) Receipts from Operations

b) Receipts from Loan Proceeds

c) Receipts from Investments

2) Disbursements

a) Disbursements of Purchases / Sub Contracting / Piecework Labour

b) Disbursement of Administrative Expenses

c) Disbursements for Capital Purchases

d) Disbursements for Debt Repayment or Dividends

3) Cash Flow Calculation

For business start-ups only

The Start-up column is used in start-up situations only. It is used for all of the receipts and disbursements that occur as a part of starting a business. This includes purchasing fixed assets, incurring start-up expenses, the initial investment to start the business and the initial bank loans. It is helpful to separate start-up costs from ongoing costs, so the reader can quickly see why you may have large deficits in the early stages of business development. Detailing Start-up expenses makes your cash flow easier to understand.

Part One - Receipts

1) **Forecast your sales on a monthly basis.** This must match the annual revenue forecast from the pro-forma income statement. It is not sufficient to simply divide by 12 and forecast the same level of sales in each month, rather you must base the monthly forecast on the seasonal nature of the business and the growth of the business.
2) **Forecast the receipts from operations** based on your accounts receivable assumptions. In a cash business, the sales forecast is the same as the revenue forecast. In a business that offers terms, there is a time delay between when the sale is made and the receivable is collected. For example, you might bill your clients in January (revenue) but get paid in February (cash receipt). Any sales that are not collected by the end of the year appear on the year-end balance sheet as accounts receivable.
3) **Forecast the receipts from term loans and investments.** Any *initial* investments or receipts of term loans, seen on the starting balance sheet, should appear in the start-up month. Any subsequent investment or loan receipts will be forecast in the month in which they will be received.
4) **Add up the total receipts.**

Part Two - Disbursements

1) **Forecast your variable costs or purchases on a monthly basis.** This involves pre-planning your purchases of inventory. Sometimes you simply replace the inventory you have used during the previous month. Sometimes you will plan to build up your inventory prior to busy sales periods. Once this forecast has been made, forecast your disbursement in this area. If you pay cash for these purchases, the disbursement is equal to the purchase. If you have credit terms from the suppliers, then the purchase in one month becomes a disbursement from accounts payable the following month. *(For example, a purchase in January becomes a disbursement in February.)*
2) **Forecast your overhead expenses on a monthly basis.** These are usually forecast in one of three ways:

a) Evenly throughout the year. Lease payments would be an example of this kind of forecast.

b) As a percentage of sales. Advertising is often disbursed this way.

c) Manually, when you know a payment is due. For example, a business licence is due every January.

3) **Forecast any principal repayments to loans.** Blended monthly payments (principal and interest) should also be accounted for here, as long as the interest is not double counted.

4) **Forecast any purchases of Capital Assets** you plan to make throughout the year. If you purchase them to start your business, account for these purchases in your start-up month.

5) **Forecast any dividends, or repayments of shareholders loans.**

6) **Add up the total disbursements.**

Part 3 - The Cash Flow Calculation

The cash flow calculation measures the end of the month cash balance with the following formula:

cash balance + cash receipts - cash disbursement = end of month cash balance.

The end of month cash balance becomes the starting cash balance of the next month. Repeat this calculation for every month.

Example - Larry's Lawn Care

Receipts

Larry is planning to start a landscaping company. He will invest $10,000 in the business, borrow $5,000 to start the business. He has forecast his revenue to be $36,000 in the first year. He realizes that his business is seasonal, so he forecasts the following monthly revenue.

Start-up	J	F	M	A	M	J	J	A	S	O	N	D	Total
Revenue	1,000	1,000	2,000	3,000	4,000	4,000	5,000	5,000	6,000	2,000	2,000	1,000	**36,000**

Larry believes that half of his sales will be cash sales, and the other half will be invoiced and paid the following month. He then accounts for his initial investment and his bank loan to complete the receipts section. (Note the relationship between the receipts and the revenue.)

	Start-up	J	F	M	A	M	J	J	A	S	O	N	D
Revenue		1000	1000	2000	3000	4000	4000	5000	5000	6000	2000	2000	1000
			Of January's sales, $500 is received in January and $500 in February.										
Receipts													
Cash		500	500	1000	1500	2000	2000	2500	2500	3000	1000	1000	500
AR			500	500	1000	1500	2000	2000	2500	2500	3000	1000	1000
Investment	10000												
Loan	5000												
Total	**15000**	**500**	**1000**	**1500**	**2500**	**3500**	**4000**	**4500**	**5000**	**5500**	**4000**	**2000**	**1500**

Disbursements

Larry estimates he will spend about 10 per cent of his revenue on variable costs. He receives 30-day credit terms from a local landscape supply company – so the costs incurred for January will be disbursed in February. (These disbursements will be made as Accounts Payable.)

Larry estimates start-up expenses of $300, monthly expenses of $500 and a monthly draw of $1500. He plans to purchase $5000 in gardening equipment a $1,000 trailer and a $2000 computer system. Larry's disbursements will look like this:

	Start-up	J	F	M	A	M	J	J	A	S	O	N	D
Cost of Goods		100	100	200	300	400	400	500	500	600	200	200	100
Disbursements													
AP			100	100	200	300	400	400	500	500	600	200	200
Overheads	300	500	500	500	500	500	500	500	500	500	500	500	500
Draw		1500	1500	1500	1500	1500	1500	1500	1500	1500	1500	1500	1500
Equipment	5000												
Trailer	1000												
Computer	2000												
Total	**8300**	**2000**	**2100**	**2100**	**2200**	**2300**	**2400**	**2400**	**2500**	**2500**	**2600**	**2200**	**2200**

Cash Flow Calculation

Take the Total Receipts line and the Total Disbursements line and forward them to the appropriate lines below. Then apply the following formula to the cash flow:

Starting Cash Balance + Receipts - Disbursements = Ending Cash Balance

Forward the ending cash balance to next month's Starting Cash Balance

	Start-up	J	F	M	A	M	J	J	A	S	O	N	D
Cash Balance	0	6700	5200	4100	3500	3800	5000	6600	8700	11200	14200	15600	15400
Plus Receipts	15000	500	1000	1500	2500	3500	4000	4500	5000	5500	4000	2000	1500
Less Disbursements	8300	2000	2100	2100	2200	2300	2400	2400	2500	2500	2600	2200	2200
Equals Ending Balance	6700	5200	4100	3500	3800	5000	6600	8700	11200	14200	15600	15400	14700

Since there are no cumulative deficits, we can continue. If the cash balance were forecast to be negative at any point, then we would have to reduce expenditures, increase initial investment, increase revenue, or arrange for a line of credit from the bank.

Although this is a very simple example of a cash flow, it should give you an idea of how to construct a cash flow for your situation. Your template does these calculations automatically – allows you to make adjustments if there are any negative balances. (If you have a negative cash balance, you are using your overdraft / line of credit to finance this deficit.) By going through each screen, you will create a first draft of your starting balance sheet, pro-forma income statement and cash flow forecast.

Notes to your Pro Forma Statements

Many entrepreneurs fail to include adequate notes and explanations to their pro-forma financials. The reader must be able to clearly understand what is being assumed within the sales numbers, salaries, and other significant figures by including detailed and well explained "notes to financials". You will also have more credibility if you compare your pro-forma statements, especially your income statement, to outside benchmarks. A great source for these benchmarks is found in *Performance Plus*. This is a part of the *Strategis* Website provided by Industry Canada. It is found at: http://strategis.ic.gc.ca/epic/internet/inpp-pp.nsf/en/h_pm00059e.html There are also books on Key Financial Ratios available in the reference sections of many public libraries.

Financing Your Business

There are two main types of financing – equity financing and debt financing. Equity is the investors' financial stake in the business. With equity financing, an investor makes money available for use in exchange for an ownership share in the business. This could be as a silent or limited partner (not actively involved in the business) or as a shareholder. Whether equity financing is possible or a good option depends on the business structure and relationship between the borrower and lender. As a business grows and profits are made they can remain in the business. This is called *retained earnings*. A company with no debt is financed completely by the shareholders or owners. In such a company the investments and profits finance the company's assets.

With debt financing, the lender charges interest for the use or rental of money loaned, but does not get a share or equity in the business. Debt financing is familiar to most people because it is the basis of most personal credit. Debt often comes from banks, but it can also come in the form of supplier credit (accounts payable) or in the form of vendor credit for capital purchases.

Bank Financing

Many entrepreneurs will go to the bank for part of their business financing. This can be financing the start-up of the business or financing the growth of an existing business. Either way, bank financing plays a major part in the development of small business. Banks use a variety of tools to finance business. The two main types are Lines of Credit and Term Loans.

Line of Credit

Line of credit is a loan similar to a personal overdraft and is used to finance temporary shortages in cash caused by inventory and accounts receivable. It is sometimes disbursed into your chequing account in increments of $5,000. The interest rates are often variable and based on the prime lending rate.

A line of credit is often subject to margin requirements. For example, a condition of your line of credit might be that the total credit available is the lesser of $200,000 or 75 per cent of current receivables and 50 per cent of inventory. You must report to the bank on a monthly basis, so make sure you have done all your invoicing before month end so it is included in your margin calculation.

Many business owners will purchase capital assets, such as machinery or equipment using their line of credit. This can create a cash flow crisis, since the credit required to finance the inventory and receivables is tied up financing the current asset. Be careful to use the right form of financing for the proper purpose.

Term Loans

Term loans are loans that are repaid over a fixed period of time – usually more than one year. A business may have several term loans at the same time financing different projects or assets. Term loans may or may not have fixed interest rates, depending on the terms and conditions. Usually, term loans are used to finance capital assets, although sometimes term loans are taken out to increase cash levels (current assets) in the business.

Leases

Leases are similar to term loans. They are often called capital leases as the business has use of the asset, and an obligation to make the lease payment.

When you develop your starting balance sheet, compare the owners' contributions to those of outside parties. This is called the Debt to Equity ratio. It shows how much money was invested for every dollar borrowed. The risk is directly related to the capital committed to the project. You cannot expect banks and lending institutions to take more risk than you take in the business.

Lending Criteria

Many banks use the four C's to evaluate loan proposals. They represent:

Cash Flow:

The ability to repay the loan with cash. This is measured using the Cash Flow Forecast in your business plan.

Collateral:

The value of internal and external security that may be liquidated. This is measured by taking the market value of the business assets and comparing this value to all outstanding term debts. This determines what might happen if the business defaults on the loan. Sometimes an asset outside of the business will secure a business loan. This is external security. An associated company may hold the asset or it may be a personal asset of the business owner. (See loan guarantees.)

Character:

Aspects about the business owner or owners, which lead you to believe in their credit worthiness. Banks often use the business owners' personal history to determine attitudes towards credit. They will also look at the technical and business skills presented in the business plan.

Commitment:

The financial commitment by the owners in this business venture. This is measured by examining the equity or shareholders loans in the business, and the retained earnings history of the business.

Statement of Personal Net Worth

A statement of personal net worth is a measure of the wealth of the owner or owners of the business. It is similar to a balance sheet – except those assets are measured at their market value. The formula for net worth is:

Net Worth = Assets (Market Value) – Liabilities

Personal Loan Guarantees

When a small corporation borrows money from a bank, the shareholders will often be required to sign what is known as a personal loan guarantee. This is like the individual co-signing a loan granted to the corporation.

It means that if the corporation (business) defaults on the loan then the individual shareholders must re-pay for the corporation. It is not unusual for the spouses of shareholders to sign guarantees as well. This prevents the guarantor (the person who signs the guarantee) from transferring their net worth to their spouse. Personal loan guarantees are required for most business loans. Always remember that the guarantee is a legal document, and it is advisable to see a lawyer before signing any such document. Couples will often be required to seek independent legal advice before signing a personal loan guarantee.

Program and Financing
(Also known as source & application of funds)

The program and financing is a description of the loan requirement and the asset purchase. It looks like a small balance sheet in that it states what you are going to purchase, and how you are going to pay for it.

Supposing that X Proprietorship wants to purchase a $5,000 piece of equipment. They decide to borrow $3,000 use $1,000 of the businesses' cash, and invest an additional $1,000 into the company.

The starting balance sheet, program and financing and pro-forma balance sheet would look like this:

	Starting Balance Sheet	Program and Financing	Pro-Forma Balance Sheet
Assets			
Current Assets			
Cash	$3,000	-$1,000.00	$2,000
Inventory	$15,000		$15,000
Accounts Receivable	$12,000		$12,000
Total Current Assets	**$30,000**		**$30,000**
Capital Assets			
Book Value (Vehicle)	$15,000		$15,000
Book Value (Equipment)	$12,000	$5,000.00	$17,000
Total Capital Assets	**$27,000**		**$27,000**
Total Assets	**$57,000**		**$57,000**
Liabilities			
Current Liabilities			
Trade Payables	$2,000		$2,000
Wages Payable	$3,000		$3,000
Line of Credit	$5,000		$5,000
Total Current Liabilities	**$10,000**		**$10,000**
Long Term Debt			
Term Loan	$10,000	$3,000	$13,000
Note Payable	$6,000		$6,000
Total Term Debt	**$16,000**		**$16,000**
Total Liabilities	**$26,000**		**$26,000**
Owners Equity	**$31,000**	**$1,000**	**$32,000**
Total Liabilities and Owners Equity	**$57,000**		**$57,000**

The program and financing and the statements of personal net worth must be provided along with the business plan to ensure the credit-worthy nature of the business venture.

Where to access financing

Contrary to popular myth, very few businesses start with any form of venture capital outside of family and friends. Sometimes, businesses will get venture capital through angels, people who specialize in helping business get started, but only after a product has been developed or a market has been established. Owner investment and debt financing are the most common means of financing a business.

Canadian Chartered banks have made every attempt to streamline the business loan application. Recently, the credit application process for business loans, even for start-up loans, has been reduced to single page applications. Loans for up to $50,000 are readily available, even to new businesses or business start-up situations.

These loans are based on the personal net worth of the principal owners of the business and the credit history of these principals. Don't forget credit unions, who tend to know their local economies very well, and if you are in a rural or smaller urban centre, try the Community Futures Development Corporation (CFDC) in your area. To locate your nearest CFDC go http://www.communityfutures.ca.

If you do not qualify for traditional bank financing, you may be able to access financing from other sources. There are programs for:

- Aboriginal Entrepreneurs
- Young Entrepreneurs
- Women Entrepreneurs
- New Immigrants

These programs change on a regular basis so check Small Business BC at www.smallbusinessbc.ca for up-to-date information. The financing page at this site, www.smallbusiness.bc.ca/financing, provides information on government, private and venture capital sources of financing. Industry Canada's Strategis site, www.strategis.ic.gc.ca also has extensive information on financing. Click on Business Support, Financing located in the left-column menu.

A hallmark of entrepreneurial thinking is the person who thinks of alternatives. This includes alternatives to start-up costs, like buying used equipment instead of new equipment – alternative product lines that are easier to manufacture and of course researching new venues for marketing your product.

A final word on your Financial Plan

A common mistake made by many businesses is developing a financial plan for a bank or an investor, and then promptly putting it away and forgetting all about it. Your financial plan should be reviewed every month. Check your plan against the actual. This will help you anticipate problems before they arise.

After completing your financial plan, you should re-examine the entire business concept in light of the results. Ask yourself if this is a good investment of your money and your time. Is the financial reward worth the lifestyle change? These are personal questions, which should be asked before that fateful trip to the bank. *It is easy to quit a job, it is difficult to quit a business!* The completed financial plan spells out the financial risks and rewards required for your new business. Only you can determine if it is worth the risk.

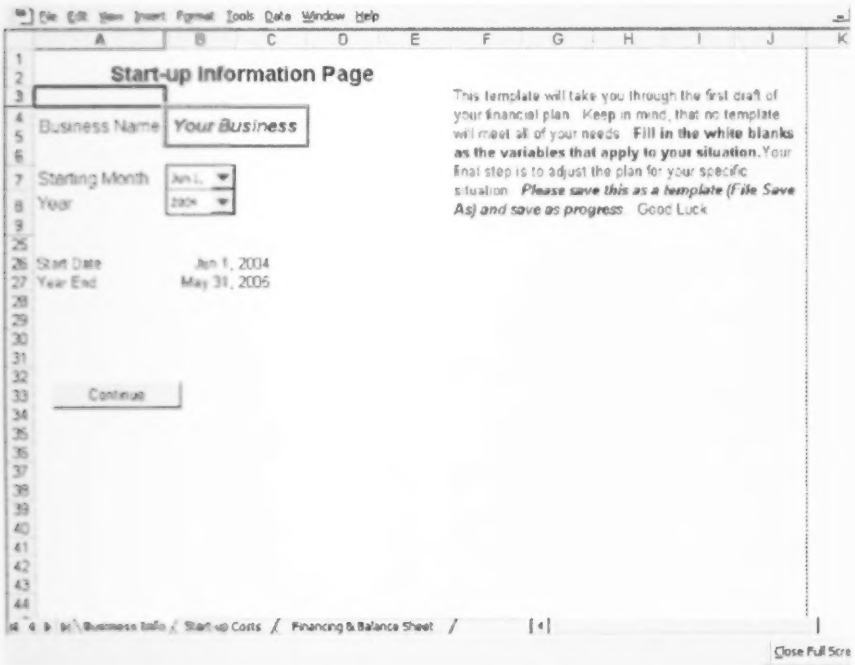
Finance is difficult for most entrepreneurs. Use professionals such as accountants or consultants to help you make sense of your financial statements. Financial plans and financial statements are a critical part of managing your business. Good luck with your planning and with your business.

The Financial Template

A Brief Operating Guide

If you are working with a print-out of this document you can locate the Excel template by clicking here or going to http://www.cse.gov.bc.ca/ReportsPublications/FinancialTemplate.XLT.

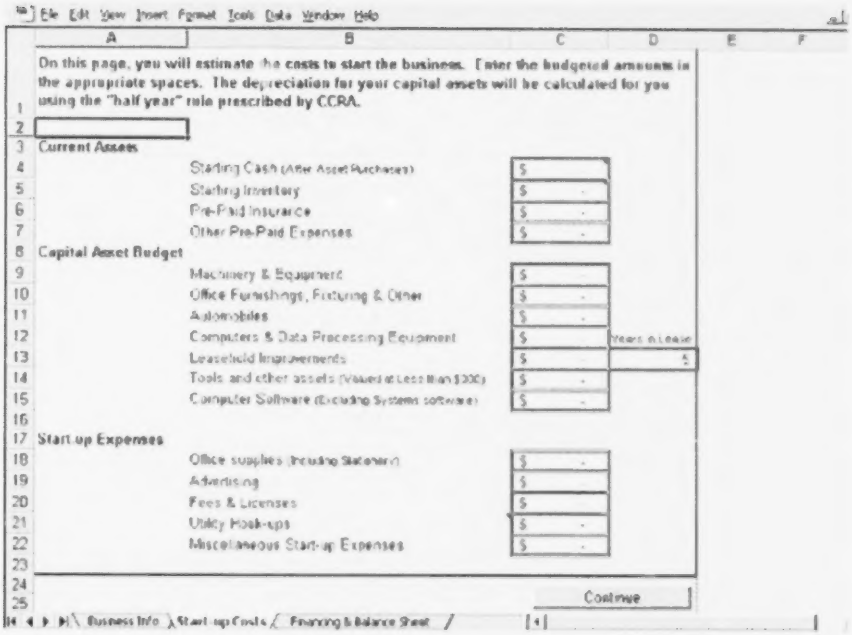
Start-up Information Page


Start-up Information Page
This template will take you through the first draft of your financial plan. Keep in mind, that no template will meet all of your needs. Fill in the white blanks as the variables that apply to your situation. Your final step is to adjust the plan for your specific situation. Please save this as a template (File Save As) and save as progress. Good Luck
Business Name
Your Business
Starting Month
Year
Start Date
Jan 1, 2004
Year End
May 31, 2005
Continue
Business Info
Start-up Costs
Financing & Balance Sheet

This is the starting page. The white cells are for required information. On this page you must:

1. **Type** in the name of the business
2. **Select** the starting month and year from the drop down menu. You must have a starting point at the beginning of the month.
3. **Select** continue and the start-up costs page will appear.

Start-up Costs Page


File Edit View Insert Format Tools Data Window Help
On this page, you will estimate the costs to start the business. Enter the budgeted amounts in the appropriate spaces. The depreciation for your capital assets will be calculated for you using the "half year" rule prescribed by CCRA.
Current Assets
Starting Cash (After Asset Purchases)
Starting Inventory
Pre-Paid Insurance
Other Pre-Paid Expenses
Capital Asset Budget
Machinery & Equipment
Office Furnishings, Fixturing & Other
Automobiles
Computers & Data Processing Equipment
Leasehold Improvements
Tools and other assets (Valued at Less than $300)
Computer Software (Excluding Systems software)
Start-up Expenses
Office supplies (including Stationery)
Advertising
Fees & Licenses
Utility Hook-ups
Miscellaneous Start-up Expenses
Years on Lease
Continue
Business Info
Start-up Costs
Financing & Balance Sheet

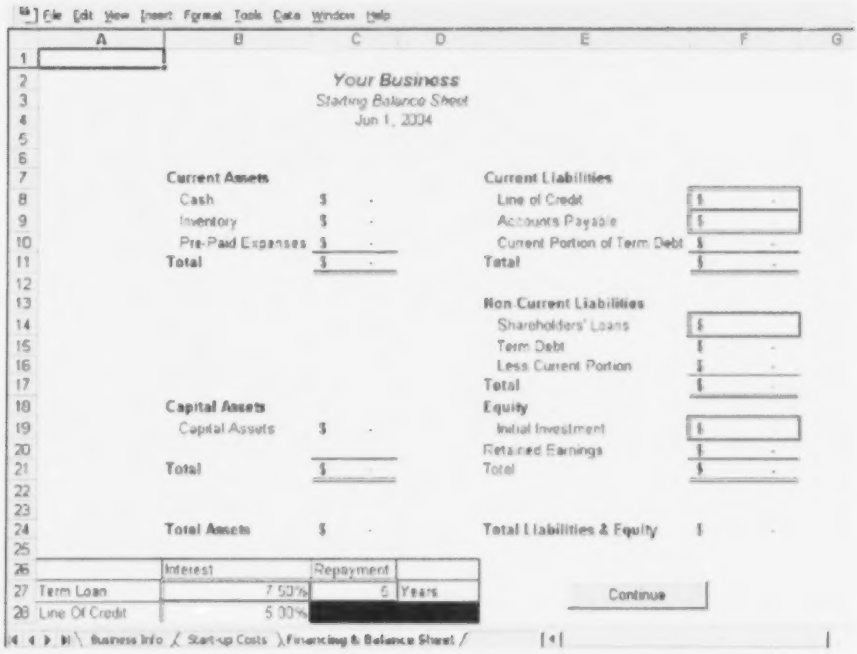
This page is to document your start-up costs. You must estimate how much it will cost to start your business. We recommend you "Save As" an .xls worksheet as your first step. This way, your original blank template remains intact.

Current Assets

1. **Estimate** the amount of cash you will have in the bank after purchasing your other assets. It must be at least as great as your start-up expenses if you plan to avoid a cash deficit before you start. You will also estimate your starting inventory and your pre paid expenses. (Remember that you can always re-visit this page after you have completed your first draft and change these estimates based on sales and cash flow.)
2. **Estimate** your capital asset requirements. Capital assets are things you generally keep for longer than one year. The depreciation on these assets (an income statement item) is automatically calculated for you using the prescribed CCA percentages from Canada Revenue Agency (CRA). Except for Leasehold Improvements, depreciation is calculated using the "declining balance" method and uses the CRA half-year rule.
3. **Start-up expenses** are non-asset purchases incurred prior to starting the business.

Select Continue to go to the next screen

Financing & Balance Sheet



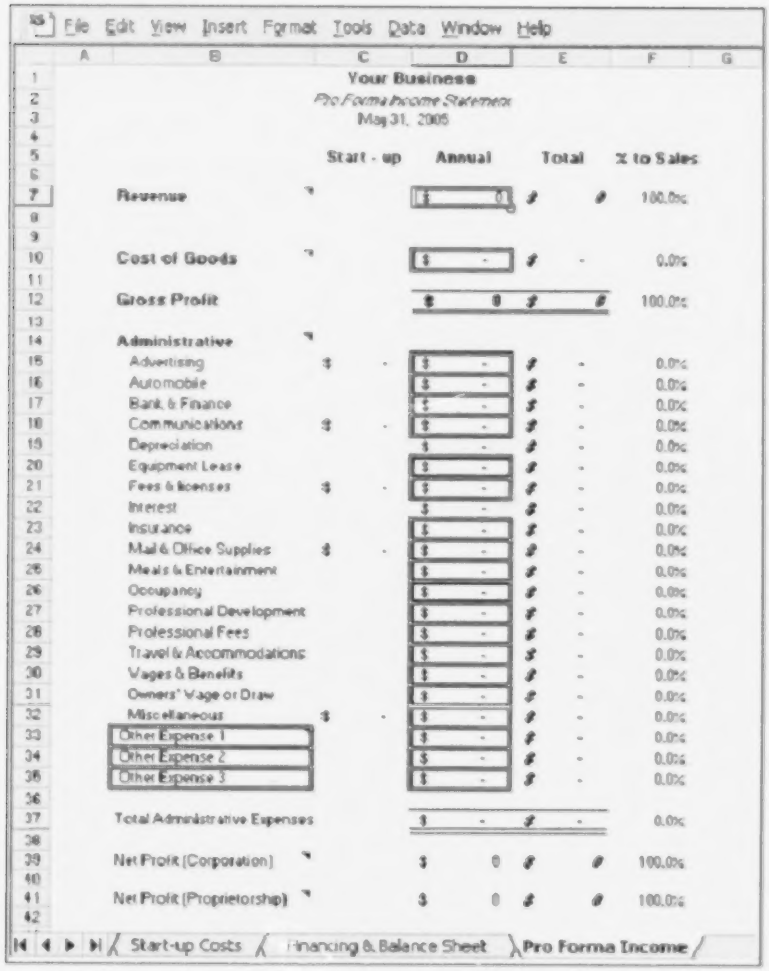
The asset information has been forwarded from your "Start-up Costs" page. You must decide how you will receive accounts payable from your suppliers for inventory, if you plan to use a line of credit to finance your business start-up (not recommended), and how much you will put into the business in terms of the initial investment and/or shareholders loans. *The remainder will automatically be borrowed in the form of a term loan.*

At the bottom of the page, you will see space for the term loan information (Interest rate and Repayment period) and the line of credit interest rate. These are defaulted at 7.5 per cent, 5 Years and 5.00 per cent respectively. Change these to the actual rates and time periods you will be paying.

Like the other pages, you can experiment with different combinations of debt and equity, and see the results on the Balance Sheet, Income Statement and Cash Flow Forecast.

Select Continue to go to the next screen.

The Pro-Forma Income Statement



File Edit View Insert Format Tools Data Window Help

Your Business
Pro Forma Income Statement
May 31, 2005

	Start - up	Annual	Total	% to Sales
Revenue		$ 0	$ 0	100.0%
Cost of Goods		$ -	$ -	0.0%
Gross Profit		$ 0	$ 0	100.0%
Administrative				
Advertising	$ -	$ -	$ -	0.0%
Automobile		$ -	$ -	0.0%
Bank & Finance		$ -	$ -	0.0%
Communications	$ -	$ -	$ -	0.0%
Depreciation		$ -	$ -	0.0%
Equipment Lease		$ -	$ -	0.0%
Fees & licenses	$ -	$ -	$ -	0.0%
Interest		$ -	$ -	0.0%
Insurance		$ -	$ -	0.0%
Mail & Office Supplies	$ -	$ -	$ -	0.0%
Meals & Entertainment		$ -	$ -	0.0%
Occupancy		$ -	$ -	0.0%
Professional Development		$ -	$ -	0.0%
Professional Fees		$ -	$ -	0.0%
Travel & Accommodations		$ -	$ -	0.0%
Wages & Benefits		$ -	$ -	0.0%
Owners' Wage or Draw		$ -	$ -	0.0%
Miscellaneous	$ -	$ -	$ -	0.0%
Other Expense 1		$ -	$ -	0.0%
Other Expense 2		$ -	$ -	0.0%
Other Expense 3		$ -	$ -	0.0%
Total Administrative Expenses		$ -	$ -	0.0%
Net Profit (Corporation)		$ 0	$ 0	100.0%
Net Profit (Proprietorship)		$ 0	$ 0	100.0%

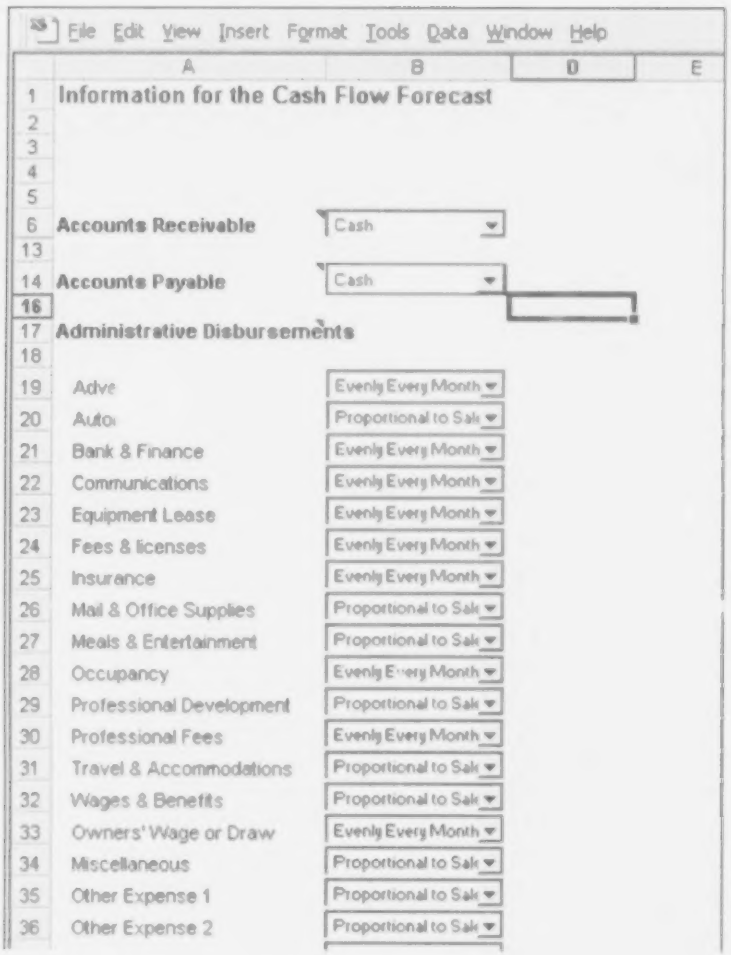
Start-up Costs | Financing & Balance Sheet | Pro Forma Income

You must now forecast your income statement. This is based on your idea of annual revenue, cost of goods, and the annual overhead expenses. Note that the "Start-up Expenses" are forwarded from the Start-up expense sheet, and the depreciation and interest are calculated for you. You can try different amounts of revenue, cost of goods and overhead expenses, and immediately see the results of the change on your net profit.

The Net Profit (Corporation) represents the profit when the owners wage is subtracted, as is the case with a corporation. The Net Profit (Proprietorship) does not subtract the owners' wage or draw. *Select continue to go to the main screen.*

Note: *The revenue is defaulted at $0.1 to eliminate the #Div 0. The rounding prevents the figure from being shown.*

Cash Flow Information



Accounts Receivable and Accounts Payable

You may now make assumptions with respect to your Accounts Receivable and Accounts Payable. Your choices are to receive your payment, or to pay your suppliers in:

- Cash
- 15 Days
- 30 Days
- 45 Days
- 60 Days

Base this on the terms you offer your clients, and the terms you are offered by your suppliers.

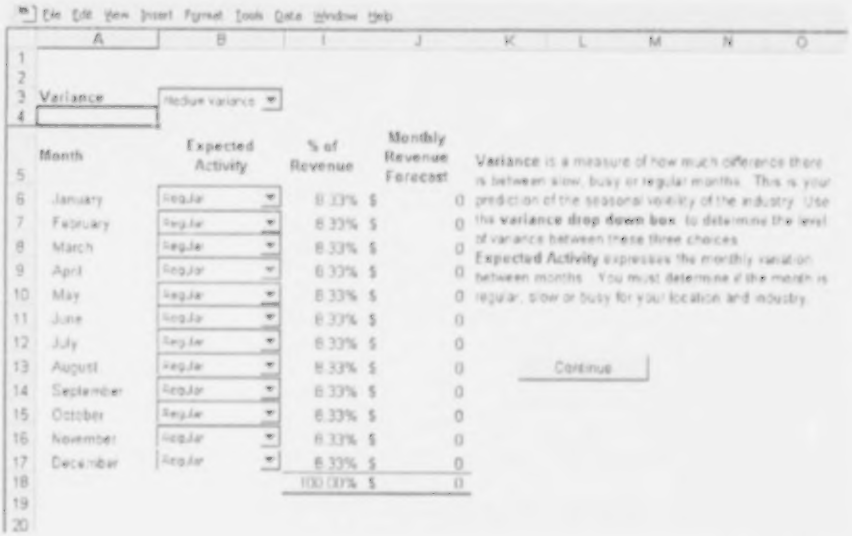
Administrative Disbursements

For each of your cash disbursements, you can choose between two alternatives. The cash is disbursed evenly throughout the year or as a percentage of the monthly sales.

A lease payment, for example, would generally be paid out evenly throughout the year, however advertising is typically paid out as a percentage to sales. If there are other choices, you must make them manually when you get to the cash flow sheet.

Select Continue to go to the next sheet.

Seasonal Adjustments



	A	B	I	J	K	L	M	N	O
1									
2									
3	Variance	Medium variance							
4									
5	Month	Expected Activity	% of Revenue	Monthly Revenue Forecast					
6	January	Regular	8.33%	$ 0					
7	February	Regular	8.33%	$ 0					
8	March	Regular	8.33%	$ 0					
9	April	Regular	8.33%	$ 0					
10	May	Regular	8.33%	$ 0					
11	June	Regular	8.33%	$ 0					
12	July	Regular	8.33%	$ 0					
13	August	Regular	8.33%	$ 0					
14	September	Regular	8.33%	$ 0					
15	October	Regular	8.33%	$ 0					
16	November	Regular	8.33%	$ 0					
17	December	Regular	8.33%	$ 0					
18			100.00%	$ 0					
19									
20									

Variance is a measure of how much difference there is between slow, busy or regular months. This is your prediction of the seasonal volatility of the industry. Use the **variance drop down box** to determine the level of variance between these three choices.

Expected Activity expresses the monthly variation between months. You must determine if the month is regular, slow or busy for your location and industry.

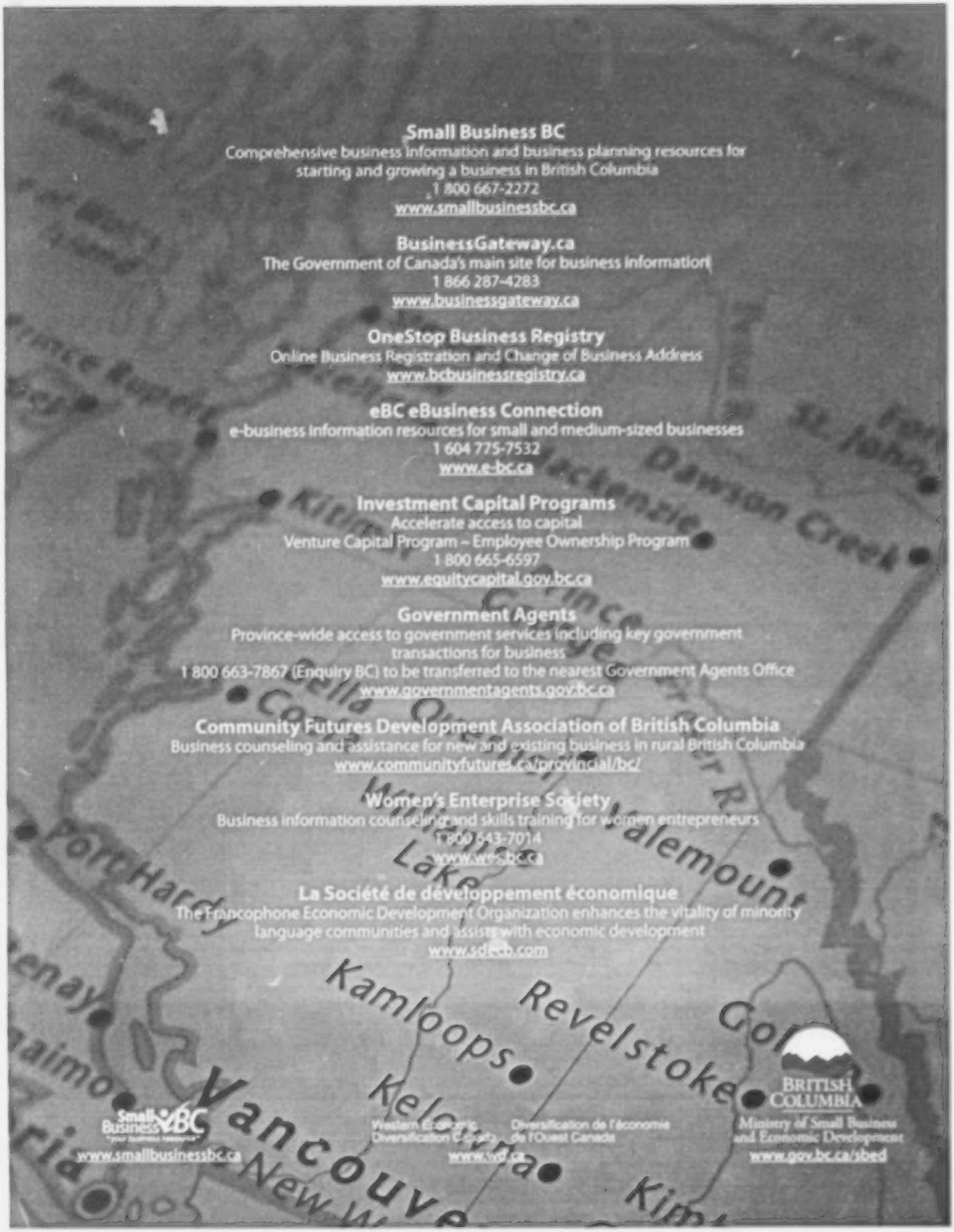
Continue

The Seasonality sheet takes the annual revenue, and allocates it into different months. There are two steps to this process. Variance is the term for the difference between regular, slow and busy months. A highly seasonal industry would have high variance. A less seasonal industry would be medium or slow.

The expected activity asks for one of three choices for each month. Will it be a slow, regular or busy month? These decisions trigger a formula for a monthly percent of sales that is displayed in the percentage of sales column. The monthly revenue forecast is the percentage of monthly sales multiplied by the annual revenue, which is taken from the pro-forma income statement. You can immediately see the effect of each choice on the monthly revenue forecast.

Select Continue, and you will see your cash flow forecast.

You can now go back and change assumptions until you are happy with the results of the financial plan. Many people find it helpful to save different versions. Simply select "Save As" from the File menu to save different versions of your plan.


Small Business BC
Comprehensive business information and business planning resources for starting and growing a business in British Columbia
1 800 667-2272
www.smallbusinessbc.ca
BusinessGateway.ca
The Government of Canada's main site for business information
1 866 287-4283
www.businessgateway.ca
OneStop Business Registry
Online Business Registration and Change of Business Address
www.bcbusinessregistry.ca
eBC eBusiness Connection
e-business information resources for small and medium-sized businesses
1 604 775-7532
www.e-bc.ca
Investment Capital Programs
Accelerate access to capital
Venture Capital Program – Employee Ownership Program
1 800 665-6597
www.equitycapital.gov.bc.ca
Government Agents
Province-wide access to government services including key government transactions for business
1 800 663-7867 (Enquiry BC) to be transferred to the nearest Government Agents Office
www.governmentagents.gov.bc.ca
Community Futures Development Association of British Columbia
Business counseling and assistance for new and existing business in rural British Columbia
www.communityfutures.ca/provincial/bc/
Women's Enterprise Society
Business information counseling and skills training for women entrepreneurs
1 800 643-7014
www.wes.bc.ca
La Société de développement économique
The Francophone Economic Development Organization enhances the vitality of minority language communities and assists with economic development
www.sdecb.com
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BRITISH COLUMBIA
Ministry of Small Business and Economic Development
www.gov.bc.ca/sbed